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FINANCIAL REGULATORY DEVELOPMENTS FOCUS

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In this week's newsletter, we provide a snapshot of the principal U.S., European and global financial regulatory developments of interest to banks, investment firms, broker-dealers, market infrastructure providers, asset managers and corporates.

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AML/CTF, Sanctions and Insider Trading

UK Proposals for a Register of Beneficial Ownership for Foreign Entities

On July 23, 2018, the U.K.'s Government Department for Business, Energy & Industrial Strategy launched a consultation on a draft Bill that would introduce a register of beneficial owners for overseas legal entities that own U.K. property. Since April 6, 2016, the U.K. has required U.K. companies, limited liability partnerships and *societates europaeae* to establish and maintain a register of persons with significant control over them and since June 30, 2016 and those entities have been required to file such information with Companies House where it is publicly available on the People with Significant Control register.

Currently, information about overseas owners of land or property is often limited to the entity's name and territory of incorporation and it is unclear who ultimately owns and/or controls the entity. The aim of the draft Bill is to prevent and combat the use of land in the U.K. by overseas entities for the purposes of laundering money or investing illicit funds.

The draft Bill will require overseas entities—which are broadly defined to encompass any legal entity, regardless of the form they take, that are governed by the law of a country or territory outside the U.K.—to take steps to identify their beneficial owners and to register them with Companies House. Registered entities will be required to update this information annually. An overseas entity that registers with Companies House will: (i) not be able to register as an owner of the land and will therefore not obtain full legal title; and (ii) will not be able to register certain dispositions through the U.K. land registries. Failure to provide the annual updated information or delivering (or causing to be delivered) misleading, false or deceptive information will be offenses.

Alongside the draft Bill, the BEIS has also published an impact assessment, a document providing an overview of the proposals and a research paper on the proposed expansion of the transparency obligations. The consultation closes on September 17, 2018.

The consultation page can be viewed at: https://www.gov.uk/government/consultations/draft-registration-of-overseas-entities-bill, the draft Bill can be viewed at: https://www.gov.uk/government/consultations/draft-registration-of-overseas-entities-bill, the overview and questions can be viewed at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/727901/2._FINAL_Overview_document__1___1_.pdf, the impact assessment can be viewed at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/727827/3._ROEBO_final_stage_impact_assessment.pdf and the research paper can be viewed at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/727828/4._ROEBO_Research_Report_FINAL.pdf.

Financial Action Task Force Publishes Report on Professional Money Laundering

On July 26, 2018, the Financial Action Task Force published a report on professional money laundering. The report is intended to assist authorities to target professional money launderers and the structures that they set up and use to launder money and to disrupt the organizations of their criminal clients. PMLs are referred to by the FATF as "individuals, organisations and networks that are involved in third-party laundering for a fee or commission." PMLs specialize in providing professional money laundering services, such as locating investments or purchasing assets, establishing companies or legal arrangements, acting as nominees, recruiting and managing networks of cash couriers or money mules, providing account management services and creating and registering financial accounts. By providing detailed explanations of the roles performed by PMLs, the FATF aims to facilitate the identification and understanding of how PMLs operate. The report

provides recent examples of financial organizations acquired by criminal operations or co-opted to aid money laundering and focuses on some of the common methods used to launder funds, such as trade-based money laundering and underground banking.

According to the FATF, a non-public version of the report examines the successful investigative tools and techniques for detecting and disrupting PMLs and makes several practical recommendations to assist authorities in countries that wish to address this issue. The report also highlights the need for coordination and information-sharing between authorities at national and international levels.

The report is available at: http://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf?_sm_au_=iVV7VQSSL75L26R7.

G20 Sets October 2018 Deadline for Financial Action Task Force to Clarify AML/CTF Standards for Crypto Assets

On July 23, 2018, the G20 Finance Ministers & Central Bank Governors issued a communiqué following their meeting in Buenos Aires on July 21–22, 2018. Among other things, the communiqué requests that the FATF clarify, by October 2018, how its global anti-money laundering and counter-terrorist financing standards apply to crypto assets.

The FATF's global standards (also known as the 40 Recommendations) promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. However, the FATF standards do not refer explicitly to crypto assets or the associated service providers and intermediaries, which creates uncertainty as to the scope of AML/CTF obligations that may apply to them.

The FATF has undertaken a stock-take of the different regulatory approaches that have been taken to crypto assets and began work in June 2018 on review of its standards. The FATF reported to the G20 in July on how it planned to take forward its work on crypto assets and its plan to consider, in October 2018, whether it needs to update its 40 Recommendations to reflect the technical aspects of crypto assets. The FATF has identified an immediate need to clarify how FATF definitions and recommendations on customer due diligence, money or value transfer services, wire transfers, supervision and enforcement apply to crypto assets providers and related businesses. In addition to this, the FATF plans to update its 2015 Risk-Based Approach Guidance on Virtual Currencies.

The new October 2018 deadline set by the G20 will necessitate the FATF completing its review within a tighter timeframe and may even require it to re-prioritize some of the planned workstreams for the U.S. presidency of the FATF, which runs from July 2018 to June 2019.

The G20 Communiqué is available at: http://www.g20.utoronto.ca/2018/2018-07-22-finance-en.pdf, details of the FATF's July 2018 report to the G20 are available at: https://finreg.shearman.com/financial-action-task-force-reports-to-g20-and-fi and the current FATF standards are available at: http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html.

Bank Prudential Regulation & Regulatory Capital

US Financial Stability Oversight Council Announces Proposed Decision to not Apply 'Hotel California' Provision to Large US National Bank

On July 18, 2018, the U.S. Financial Stability Oversight Council issued a proposed decision with respect to a national bank's petition to not treat the surviving entity of a bank holding company parent merging into its large U.S. national bank subsidiary as a nonbank financial company supervised by the U.S. Board of

Governors of the Federal Reserve System pursuant to Section 117 of the Dodd Frank Act (commonly referred to as the "Hotel California" provision). Section 117 applies to any entity, or its successor entity, that received financial assistance under, or participated in, the Capital Purchase Plan established under the Troubled Asset Relief Program and was a bank holding company with total consolidated assets of at least $50 billion as of January 1, 2010. If an entity meeting these requirements ceases to be a bank holding company, Section 117 requires that the entity be treated as a nonbank financial company supervised by the Federal Reserve Board as if the FSOC had made this determination under Section 113 of the Dodd-Frank Act. Section 117, however, provides a mechanism by which the affected entity can appeal its treatment as a nonbank financial company supervised by the Federal Reserve Board. In considering these appeals, the FSOC considers whether material financial distress experienced by the entity, or the nature, scope, size, scale, concentration, interconnectedness or mix of the activities of the entity, could pose a threat to U.S. financial stability. In evaluating this standard, the FSOC considers three transmission channels—exposure, asset liquidation and critical function or service—which are intended to inform the extent to which any material financial stress could be transmitted to other financial firms. In reaching its proposed decision to grant the appeal of the petitioner, the FSOC determined that there was not any significant risk that material financial distress experienced by the bank would pose a threat to U.S. financial stability through these three transmission channels. In addition, the FSOC considered to what extent any material distress at the bank would be mitigated by the complexity or resolvability of the bank. The FSOC found that while the failure of the appealing entity would be one of the largest U.S. bank failures, such a failure would be mitigated by the fact that a resolution of the failed entity would be relatively straightforward. The FSOC also noted that the surviving bank entity currently is, and would continue to be, subject to extensive regulation and supervision by the U.S. Office of the Comptroller of the Currency, U.S. Federal Deposit Insurance Corporation and U.S. Consumer Financial Protection Bureau.

The FSOC noted that any determination to grant the bank's appeal would be conditioned on the completion of the bank's proposed merger under the terms of the merger agreement within 90 days of the FSOC's final decision. The OCC and FDIC have already approved the proposed merger.

The full text of the FSOC's proposed decision is available at:
https://home.treasury.gov/sites/default/files/2018-07/ZB%20NA.pdf.

UK Regulator Consults on Changes to Definition of Default for Credit Risk

On July 27, 2018, the Prudential Regulation Authority opened a consultation on proposals to implement the European Banking Authority's recent regulatory products on the definition of default in the Capital Requirements Regulation. The CRR risk quantification provisions set out that a default occurs when an obligor is past due more than 90 days on any material credit obligation to a firm, its parent or any of its subsidiaries. The materiality of the credit commitment is to be assessed against a threshold set by the national regulator according to its view of a reasonable level of risk.

The EBA developed a roadmap of regulatory products that aim to reduce unwarranted variability in the risk weighted assets calculated using banks' Internal Ratings-Based models. Three of these products pertain to the definition of default: the Regulatory Technical Standards on the materiality threshold for credit obligations past due, the Guidelines on the application of the definition of default and the EBA Opinion on the use of the 180 days past due criterion.

The PRA is proposing to update its expectations in the Supervisory Statement 'Internal Ratings Based (IRB) approaches' (SS 11/13) and to amend the Credit Risk Part of the PRA Rulebook to set thresholds for determining whether a credit obligation is material for the purpose of the CRR's definition of default. As

required by the CRR and the RTS, the PRA proposes setting materiality thresholds that it considers reflect a reasonable level of risk for retail and non-retail exposures. In particular, the PRA is intending to amend the PRA Rulebook to:

- set a 0% relative materiality threshold and zero absolute materiality threshold for retail exposures;
- set a 1% relative materiality threshold and a sterling equivalent of €500 absolute materiality threshold for non-retail exposures;
- remove the PRA's exercise of the discretion to use 180 days instead of 90 days in the 'days past due' component of the definition of default for exposures secured by residential or SME commercial real estate in the retail exposure class and/or exposures to public sector entities.

The PRA intends to amend the relevant Supervisory Statement to reflect the EBA's Guidelines, including that it does not expect firms to replace 90 days with 180 days in the 'days past due' component of the definition of default for any exposure class.

The proposals are relevant to U.K. banks, building societies and PRA-designated U.K. investment firms. The proposals relating to the RTS and Guidelines apply to firms using the standardized approach and firms using the IRB approach for calculating capital requirements for credit risk. The proposals relating to the EBA Opinion apply to IRB firms only.

Responses to the consultation should be submitted by October 29, 2018. The PRA proposes that the changes will take effect from December 31, 2020, in line with the EBA's proposed deadline for implementation of the EBA roadmap.

Once the EBA has finalized the outstanding parts of the EBA roadmap, the PRA will consult on how it intends to implement them. The remaining aspects are the Guidelines on probability of default estimation, loss given default estimation and the treatment of defaulted exposures and the technical standards on specification of the nature, severity and duration of an economic downturn.

The consultation paper is available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp1718.pdf?la=en&hash=C274852EB4D43C96C0C042058D820B1832D52F3F, the PRA's existing Supervisory Statement (SS 11/13) is available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2017/ss1113update2.pdf?la=en&hash=F70C24A42A2B2052475978F6BA07BE0F9C5315D7, the PRA's existing Credit Risk Rules are available at: http://www.prarulebook.co.uk/rulebook/Content/Part/211370/30-07-2018, the EBA Opinion is available at: http://www.eba.europa.eu/documents/10180/2071742/EBA+BS+2017+17+%28Opinion+on+the+use+of+180+DPD%29.pdf, the RTS is available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0171&from=EN and the EBA Guidelines are available at: https://www.eba.europa.eu/documents/10180/1597103/Final+Report+on+Guidelines+on+default+definition+%28EBA-GL-2016-07%29.pdf/004d3356-a9dc-49d1-aab1-3591f4d42cbb.

Bank Structural Reform

UK Secondary Legislation Published to Align Ring-Fencing With Financial Sanctions Legislation

On July 24, 2018, the Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) (Amendment) Order 2018 was made and will come into force on October 31, 2018.

The Amendment Order amends the definition of a "core deposit" (set out in The Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014) for the purposes of the U.K. framework for the ring-fencing of retail from wholesale/investment banking. Under the U.K. framework, if a deposit is not a "core deposit," then carrying on the regulated activity of accepting deposits in relation to that non-core deposit can take place in the non-ring-fenced bank.

The effect of the Amendment Order is to exclude from the definition of "core deposit" any deposit where one or more of the account holders is, or at any point within the previous six months has been, subject to financial sanctions. This aligns the requirements between the U.K.'s ring-fencing legislation and the financial sanctions regimes that would otherwise conflict and will ensure that banking groups can maintain accounts held by sanctioned account holders in their existing locations whilst still complying with ring-fencing legislation.

The Amendment Order (S.I. 2018/897) is available at: http://www.legislation.gov.uk/uksi/2018/897/pdfs/uksi_20180897_en.pdf and the explanatory memorandum is available at: http://www.legislation.gov.uk/uksi/2018/897/pdfs/uksiem_20180897_en.pdf.

Brexit for Financial Services

UK White Paper Published on How the Withdrawal Agreement Will Be Implemented in the UK

On July 24, 2018, the U.K.'s Department for Exiting the EU published a further Brexit white paper, entitled: "Legislating for the Withdrawal Agreement between the United Kingdom and the European Union." The paper describes the Bill that will implement the terms of the Withdrawal Agreement in the U.K. The Bill, which must pass before exit day (March 29, 2019) will only be introduced once Parliament has approved the finalized Withdrawal Agreement as required under the EU (Withdrawal) Act 2018. In the paper, the Government sets out how it envisages the Bill will implement the U.K.'s withdrawal and provides detail on those parts of the draft Withdrawal Agreement that have been agreed so far: citizens' rights, the implementation period and the negotiated financial settlement. The final provisions of the Bill will be subject to the final terms of the Withdrawal Agreement. The paper also sets out the procedures for Parliament's approval of the terms of the final Withdrawal Agreement.

The Government confirms that in tandem it is preparing for a "hard Brexit" and will continue to prepare legislation for that outcome as well as for the end of the implementation period. The paper notes that Parliament is already scrutinizing the Taxation (Cross-border Trade) and Trade Bills and that the Sanctions and Anti-Money Laundering, Nuclear Safeguards and Haulage Permits and Trailer Registration Acts have already been passed. The Government foresees that secondary legislation will continue to be made under the EU (Withdrawal) Act 2018 in the period leading up to exit day.

Legislation implementing the agreed future relationship between the EU and the U.K. will be made separately. That legislation falls within the scope of the white paper published by the DxEU on July 12, 2018.

The Government welcomes comments on the paper.

The white paper is available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/728757/6.4737_Cm9674_Legislating_for_the_withdrawl_agreement_FINAL_230718_v3a_WEB_PM.pdf.

Details of other Brexit-related developments, including the white paper on the future relationship and the EU (Withdrawal) Act 2018 are available at: https://finreg.shearman.com/focus?categoryID=1013&yearmonth=0.

UK Secondary Legislation Published for Post-Brexit Temporary Permissions Regime

On July 24, 2018, a draft of one of several pieces of U.K. legislation was published, that will establish a temporary permissions regime after the U.K.'s withdrawal from the EU. Temporary permission will be available for EEA firms currently operating in the U.K. under financial services passports. The draft EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 are expected to be laid before Parliament in Autumn 2018 and to come into force mainly on the day after they are made, apart from some provisions that will apply on the day the U.K. withdraws from the EU. The draft Regulations also amend the Financial Services and Markets Act 2000 and related legislation to remove references to EEA passport rights.

The draft Regulations have been prepared under the provisions of the EU (Withdrawal) Act 2018, which sets out an enhanced scrutiny procedure for secondary legislation used to amend certain retained EU law. This means that the draft Regulations will require the approval of both Houses of Parliament before they are made.

The Bank of England, the PRA and the Financial Conduct Authority have previously made clear that permanent U.K. authorization for passported activities will only be needed by the end of the transitional, or "implementation," period (March 29, 2019 to December 31, 2010) which has been agreed in principle between the U.K. and the EU, but which will need to be ratified under the Withdrawal Agreement currently under negotiation and is subject to agreements being forthcoming in other areas. The temporary permissions regime is designed to act as a backstop in the event of a "no deal" scenario, in which the implementation period is not ratified under the Withdrawal Agreement. Temporary permission would deem firms within the regime as authorized for their current activities for a maximum of three years, subject to a power for HM Treasury to extend the regime's duration by increments of 12 months.

Firms that will be eligible for temporary permission are those authorized to carry on a regulated activity in the U.K. under an EEA passporting right, that have either applied for U.K. authorization prior to the U.K. withdrawal date or have notified the relevant U.K. regulator of their intention to continue carrying on passported activities. The temporary permissions regime will be available both for inwardly passported branches and to those with a services (cross-border) passport but no U.K. place of business. However, full authorization (after the temporary regime expires) would typically require the establishment of a place of business in order for the firm to meet the threshold conditions for authorization. The draft Regulations will temporarily extend, up to three years, the statutory time limits imposed on the regulators to deal with authorization applications or applications to vary permissions, so that they are able to manage, in a smooth and orderly way, the volume of applications expected to be made as a result of EU withdrawal.

The BoE and the FCA have separately issued statements on the draft Regulations. The regulators expect to consult, separately or in coordination with each other where appropriate, on changes to their broader rules in Autumn 2018.

The draft Regulations are available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/728567/EEA_passport_rights_draft_SI.pdf, the explanatory guidance is available at: https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act/eea-passport-rights-amendment-etc-and-transitional-provisions-eu-exit-regulations-2018, the FCA statement on the temporary permissions regime is available at: https://www.fca.org.uk/news/news-stories/update-temporary-permissions-regime, the BoE statement on the temporary permissions regime is available at: https://www.bankofengland.co.uk/news/2018/july/temporary-permissions-and-recognition-regimes.

UK Legislation Published for a Post-Brexit Recognition Regime for CCPs

On July 24, 2018, a draft of the Central Counterparties (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 was laid before Parliament. The finalized Regulations will come into force partly on the day after the day they are made and fully on the day the U.K. withdraws from the EU.

The draft Regulations have been prepared using the power under the European Union (Withdrawal) Act 2018 to address failures of retained EU law to operate effectively or other deficiencies arising from the withdrawal of the U.K. from the EU. These draft Regulations deal with "onshoring" certain aspects of the European Market Infrastructure Regulation that relate to the regulatory framework for CCPs. The BoE wrote to non-U.K. CCPs in December 2017 outlining how it envisaged that non-U.K. CCPs will be recognized to provide services in the U.K. once the U.K. has withdrawn from the EU. Recognized status under EMIR enables third-country CCPs to provide clearing services to clearing members or trading venues established in the EU. The BoE explained in its letter that U.K. domestic law requirements for the recognition of non-U.K. CCPs would be substantially the same as the current requirements under EMIR, although references to international MoUs being in place would change, such that these must be established between third countries and relevant U.K. authorities.

The draft Regulations:

- Transfer to HM Treasury the European Commission's function to make equivalence determinations under EMIR. An equivalence determination in respect of a third-country jurisdiction is a necessary precondition for CCPs from that jurisdiction to obtain recognized status. The draft Regulations revoke Commission Implementing Acts that relate to third-country equivalence under EMIR; however, the expectation is that third countries already declared equivalent by the Commission for the purposes of EMIR are likely to be re-designated as equivalent under the U.K.'s post-Brexit EMIR law.
- Empower the BoE with the functions, currently held by the European Securities and Markets Authority, of recognizing third-country CCPs. BoE recognition will enable third-country CCPs to provide these services to U.K. clearing members and venues.
- Create a temporary recognition regime, designed to act as a backstop in the event of a "no deal" scenario, in which the transition, or "implementation" period (March 29, 2019 to December 31, 2020) agreed in principle between the U.K. and the EU is not ratified under the Withdrawal Agreement that is currently under negotiation. Under the temporary regime, CCPs providing clearing services in the EU by virtue of recognized status under EMIR would be deemed to have recognized status and be able to continue their activities in the U.K. for a limited period after the date of the U.K. withdrawal, subject to prior notification to the BoE. The temporary regime would remain in place for three years, subject to a power for HM Treasury to extend the regime's duration by increments of 12 months.
- Give power to the BoE to charge fees from non-U.K. CCPs that are providing services in the U.K.

Two further pieces of secondary legislation planned for publication in 2018 will deal with onshoring other provisions of EMIR. These are: (i) the Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018; and (ii) the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment) (EU Exit) Regulations 2018.

The EU (Withdrawal) Act 2018 sets out an enhanced scrutiny procedure for secondary legislation used to amend certain retained EU law. This means that the draft Regulations will require the approval of both Houses of Parliament before they are made.

The draft Regulations are available at: http://www.legislation.gov.uk/ukdsi/2018/9780111171882/pdfs/ukdsi_9780111171882_en.pdf, the explanatory memorandum is available at: http://www.legislation.gov.uk/ukdsi/2018/9780111171882/pdfs/ukdsiem_9780111171882_en.pdf, the BoE's December 2017 letter to CCPs is available at: https://www.bankofengland.co.uk/-/media/boe/files/letter/2017/letter-to-ccps.pdf?la=en&hash=544DA5A3C8759C5D16D66FC5C269452912B8EF3F.

UK Plans Temporary Designation Regime for Settlement Finality Designation Post-Brexit

On July 24, 2018, the U.K. Government announced that it intends to legislate to ensure, after U.K. withdrawal from the EU, the continuation of U.K. settlement finality protections currently provided under the Settlement Finality Directive and implemented in the U.K. by the Financial Markets and Insolvency (Settlement Finality) Regulations 1999. The SFRs establish various insolvency carve-outs for designated market infrastructure systems and also legislate for finality of transactions within such systems. However, only EU systems are in scope.

The SFD requires Member States to notify the European Securities and Markets Authority with information concerning the national systems (and the respective system operators) they have designated to be included within the scope of the SFD protections. Member States must also designate the national authorities that must be notified when insolvency proceedings are opened against a participant or a system operator. Under the protections afforded by the SFD, transfer orders which enter into designated systems within certain deadlines are guaranteed to be finally settled, regardless of whether the sending participant has become insolvent or transfer orders have been revoked in the meantime. Under the SFD, each Member State automatically recognizes systems that have been designated by other Member States.

On the U.K.'s withdrawal from the EU, the U.K. will no longer fall within the SFD framework for automatic recognition. To maintain legal certainty for EU systems that conduct business with U.K. participants, HM Treasury proposes to legislate to allow designations, under domestic law, of non-U.K. financial market infrastructures, including FMIs outside the EU. It also proposes to give the BoE functions and powers to grant permanent designation to non-U.K. FMIs. This proposed new legislation is noteworthy in that it may be the first example of post-Brexit legislation that not only addresses Brexit issues but arguably promotes the U.K. Government's vision of a "global Britain." Settlement systems around the world will potentially be capable of being afforded the same insolvency law and finality protections under U.K. laws as are afforded to EU systems—something that the EU has omitted to achieve during the almost two-decade long life of the SFD to date, despite this being a widely-known deficiency in the legislation. Furthermore, the proposed legislation will provide for a temporary SFD designation regime that would enable EU systems currently designated under the SFD to be easily grandfathered into benefitting from SFD protections upon Brexit, in advance of permanent designation being granted.

Permanent designation for non-U.K. FMIs will only be needed by the end of the transitional, or "implementation," period (March 29, 2019 to December 31, 2020) which has been agreed in principle between the U.K. and the EU and which will need to be ratified under the Withdrawal Agreement currently under negotiation. The temporary designation regime is designed to act as a backstop in the event of a "no deal" scenario, in which the implementation period is not ratified under the Withdrawal Agreement. The legislation will maintain legal certainty for EU systems that conduct business with U.K. participants, whatever the outcome of negotiations between the U.K. and the EU.

The BoE has written a "Dear CEO" letter to the operators of systems currently designated under the SFD, explaining that the BoE anticipates that the forthcoming U.K. legislation will in essence impose the same designation requirements as are currently required under the U.K. legislation implementing the SFD. The BoE outlines in the Dear CEO letter how it envisages the designation process will take place, the requirements for, and the effect of, obtaining temporary U.K. designation and which systems would need U.K. designation post-Brexit. The BoE encourages the operators of affected systems to engage in pre-application discussions with it by replying to the letter and indicating whether their systems will continue to need the protections afforded by designation following Brexit.

The announcement from HM Treasury is available at: https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act and the BoE "Dear CEO" letter to EU systems is available at: https://www.bankofengland.co.uk/-/media/boe/files/letter/2018/letter-to-eu-systems-designated-under-the-settlement-finality-directive.pdf.

Consumer Protection

US Federal Reserve Board Launches New Consumer Protection Bulletin

On July 26, 2018, the Federal Reserve Board launched the Consumer Compliance Supervision Bulletin. The bulletin will be published by the Federal Reserve Board's Division of Consumer and Community Affairs, and will provide high-level summaries of supervisory issues, highlight violations that have been identified, include practical guidance with respect to the management of consumer compliance risks and enhance transparency with respect to the Federal Reserve Board's consumer compliance supervisory program. The current issue of the bulletin includes content with respect to fair lending, unfair or deceptive acts or practices and regulatory and policy developments.

The full text of the bulletin is available at: https://www.federalreserve.gov/publications/files/201807-consumer-compliance-supervision-bulletin.pdf.

UK Regulator Consults on EU Packaged Retail and Insurance-based Investment Products Regulation

On July 26, 2018, the FCA issued a call for input on the Packaged Retail and Insurance-based Investment Products Regulation. Since January 1, 2018, the EU PRIIPs Regulation has required manufacturers of PRIIPs to prepare and publish a stand-alone, standardized Key Information Document for each of their PRIIPs. Those advising retail investors on PRIIPs, or selling PRIIPs to retail investors, must provide retail investors with a KID in good time before the transaction is concluded.

The FCA is seeking input about the initial experience of: (i) those producing, advising on, or distributing PRIIPs and preparing and providing KIDs; and (ii) consumers using KIDs to decide whether to invest in these investment products. In addition, the FCA is asking for feedback on the scope of the PRIIPs Regulation, in particular, which instruments fall in or out of the scope of the requirements, and on practical aspects of certain cost and risk disclosure requirements.

Feedback to the call for input should be provided by September 28, 2018. The FCA intends to publish a feedback statement in Q1 2019.

The call for input can be viewed at: https://www.fca.org.uk/publication/call-for-input/priips-regulation-initial-experiences-with-the-new-requirements.pdf.

UK Regulator Proposes Changes to Rules Governing Peer-to-Peer Lending Platforms

On July 27, 2018, the FCA launched a consultation on new rules for loan-based crowdfunding platforms, also known as peer-to-peer lending platforms. The FCA implemented rules regulating FCA-authorized firms operating investment-based and loan-based crowdfunding platforms on April 1, 2014. Investment-based crowdfunding is governed by the Markets in Financial Instruments package and the Alternative Investment Fund Managers Directive, as transposed into U.K. law. The regime for P2P lending is a national one and is less detailed and prescriptive.

The FCA began a post-implementation review of the crowdfunding sector and the applicable regimes in 2016. In the post-implementation review, the FCA identified that harm may be caused to investors as a result of poor business practices and due to the business models that some platforms have adopted. The consultation paper summarizes the FCA's findings from that review and sets out the FCA's proposals to change certain rules and guidance.

The FCA's review concludes that the framework for investment-based crowdfunding is mostly adequate. Where issues have been identified, the FCA proposed clarifications to the existing rules, but no new requirements.

For P2P crowdfunding, the FCA is proposing a package of additional rules and guidance which are intended to formalize requirements and improve standards, without thwarting innovation. The main changes proposed include requiring P2P platforms to:

- provide clear and accurate information about a potential investment to investors;
- ensure investors are adequately remunerated for the risk they are taking;
- have transparent and robust systems for assessing the risk, value and price of loans as well as fair and transparent charges to investors;
- have good governance arrangements and orderly business practices, including preparing for winding down; and
- comply with the existing marketing restrictions for investment-based crowdfunding platforms.

Responses to the consultation should be submitted by October 27, 2018. The FCA intends to publish a feedback statement in Q2 2019.

The consultation paper is available at: https://www.fca.org.uk/publication/consultation/cp18-20.pdf and details of the FCA's review are available at: https://finreg.shearman.com/uk-regulator-launches-review-of-crowdfunding-rule.

Enforcement

Five EU Banks Fined for Issuing Credit Ratings Without Authorization

On July 23, 2018, ESMA fined five EU banks for issuing credit ratings without being authorized to do so by ESMA. The Credit Rating Agencies Regulation requires firms to register with ESMA as a Credit Rating Agency before issuing credit ratings to ensure that such ratings are independent, objective and of adequate quality.

ESMA found that the banks had each issued credit research to their clients that included shadow ratings and opinions. ESMA deemed that these aspects of the reports amounted to a credit rating as defined in the CRA Regulation. None of the five banks have been authorized by ESMA under the CRA Regulation, nor have any of them applied for such authorization.

The banks have a right of appeal to the Board of Appeal of the European Supervisory Authorities.

The ESMA's press release and decision notices can be viewed at: https://www.esma.europa.eu/press-news/esma-news/esma-fines-five-banks-%E2%82%AC248-million-issuing-credit-ratings-without-authorisation.

Payment Services

Bank of England Confirms its Renewed Real-Time Gross Settlement System Can Interface With DLT

On July 23, 2018, the BoE published the outcomes from a "Proof of Concept" it ran to understand how its renewed Real-Time Gross Settlement service could be capable of supporting settlement in systems operating on innovative payment technologies, such as those built on Distributed Ledger Technology. The BoE has operated the RTGS service since 1996 to provide a safe and reliable means of settling high-value cash payments in real time in sterling central bank money. The BoE published a blueprint for renewal of the RTGS in May 2017, setting out how it proposed to overhaul the system to ensure higher resilience, broader access, wider interoperability, improved user functionality and strengthened end-to-end risk management of the high-value payment system.

For the POC, the BoE partnered with a range of firms developing payment arrangements using innovative technologies. All participants in the POC confirmed that the functionality offered by the renewed RTGS service would enable their systems to connect and to achieve settlement in central bank money. The outcomes of the POC will inform the BoE's ongoing work on RTGS renewal. In particular, the BoE proposes to: (i) consider how different account structures could be used in the renewed RTGS service; (ii) investigate whether the renewed RTGS service could provide and consume acceptable forms of cryptographic proofs; and (iii) continue to engage with FinTech firms to keep up to date with innovation in payment technology.

The POC outcomes document is available at: https://www.bankofengland.co.uk/news/2018/july/rtgs-renewal-programme-proof-of-concept-supporting-dlt-settlement-models and the BoE's RTGS renewal webpage is available at: https://www.bankofengland.co.uk/payment-and-settlement/rtgs-renewal-programme.

UK Payment Systems Regulator Will Review Supply of Card-Acquiring Services

On July 24, 2018, the U.K. Payment Systems Regulator published for consultation its draft terms of reference for a planned market review into the supply of card-acquiring services in the U.K. Merchants that accept card payments from customers purchase card-acquiring services from specialist providers to enable card payments to be accepted and processed on their behalf. The market review is a response to concerns raised by stakeholders that the supply of these services may not be working well for some merchants and, ultimately, consumers.

The market review will examine: (i) the nature and characteristics of card-acquiring services; (ii) the providers of these services and how their market shares have developed historically; (iii) how merchants buy card-acquiring services; (iv) the availability of credible alternatives to card-acquiring services for some or all merchants; and (v) how competition is working in the sector, including looking at issues around the fees merchants pay and the quality of service they receive.

The PSR is inviting feedback on its draft terms of reference until September 14, 2018. The PSR intends to publish finalized terms of reference, including a timetable for the review, before the end of 2018.

The draft terms of reference for the review (MR 18/1.1) are available at: https://www.psr.org.uk/psr-publications/consultations/mr18_1.1_draft_tor_card_aquiring_services.

Recovery & Resolution

Federal Reserve Bank of New York Executive Vice President and Director of Research Discusses Supervisory Stress Testing Objectives

On June 22, 2018, Federal Reserve Bank of New York Executive Vice President and Director of Research, Beverly Hirtle, discussed the macroprudential objectives of supervisory stress testing; focusing on structural and cyclical macroprudential considerations. Ms. Hirtle contended that stress testing is a set of microprudential supervisory tools that achieve macroprudential objectives, and that the Comprehensive Capital Analysis and Review program and the Dodd-Frank Act Stress Test are the "most significant and impactful of the many regulatory and supervisory changes implemented following the global financial crisis." Ms. Hirtle's remarks compared the current stress testing regime against the Supervisory Capital Assessment Program (SCAP)—the first set of stress tests that were conducted by federal financial regulators. Ms. Hirtle made this comparison against the backdrop of six elements: comprehensiveness; consistency; multiple, independent estimates; diverse perspectives; transparency of process and results; and clear and predictable goals and actions. Overall, Ms. Hirtle suggested that while factors such as the narrowing focus on the most systemically important financial institutions seem consistent with addressing structural macroprudential considerations, the role that cyclical macroprudential considerations serve in the current and evolving stress testing regime is becoming less apparent; arguing that these considerations may be receiving less emphasis given the current economic expansion. Regardless of her observations, however, Ms. Hirtle reiterated that stress testing is vital in ensuring a safe, sound and stable financial system.

The full text of Ms. Hirtle's remarks is available at: https://www.newyorkfed.org/newsevents/speeches/2018/hir180622.

Securities

European Banking Authority Recommendations for Proposed Introduction of European Secured Notes

On July 24, 2018, the EBA published a final report in response to a call for advice from the European Commission, in the context of the Commission's Capital Markets Union project, to help the Commission assess the case for the case for introducing European Secured Notes, an additional instrument which would be available for institutions to gain funding on the capital markets, particularly infrastructure loans and loans to Small and Medium Sized Enterprises. ESNs are defined in the call for advice as "dual recourse financial instruments on an issuer's balance sheet applying the basic structural characteristics of covered bonds to two non-traditional cover pool assets—SME bank loans and infrastructure bank loans."

The Commission asked the EBA to assess whether a dual recourse instrument, similar to covered bonds, may provide a useful funding option to banks engaged in lending to SMEs and infrastructure projects and to determine an appropriate EU framework and regulatory treatment for this new product.

In the final report, the EBA: (i) assesses the business case for ESNs; (ii) analyzes the potential implications of issuances of ESNs on asset encumbrance; and (iii) considers the risk profile of SME loans and project finance. The EBA makes suggestions on the pool eligibility criteria and the structure and features of ESNs and on their potential regulatory treatment.

The EBA makes five main policy recommendations on crucial aspects for the Commission to consider when possibly designing the legislative framework for ESNs. These relate to the structure, cover assets and regulatory treatment of SME ESNs, the EBA's reservations about introducing Infrastructure ESNs and the impact of ESNs on asset encumbrance.

The final report is available at:
http://www.eba.europa.eu/documents/10180/2087449/EBA+Final+report+on+ESNs.pdf.

UK Working Group Outlines Risk Mitigation Considerations for Bond Market Participants During Transition From LIBOR

On July 23, 2018, the U.K. Working Group on Sterling Risk-Free Reference Rates published a paper to raise awareness among market participants of some of the current market uncertainties surrounding issuance of long-dated bonds referencing LIBOR. The Working Group is tasked with helping to bring about broad-based transition to the Sterling Overnight Index Average rate by end-2021 across Sterling bond, loan and derivative markets. SONIA has been selected as the preferred alternative risk-free rate for Sterling and, among other work, the Working Group is in the process of developing market conventions for SONIA-linked bonds. A key milestone for the Working Group will be its publication, later in 2018, of best practice for referencing SONIA in bond markets.

In the paper, the Working Group outlines some of the risks faced by bond market participants who are continuing to issue, offer and purchase new Sterling bonds referencing LIBOR, in particular where those bonds are long-dated. "Long-dated" refers to bonds set to mature beyond the end of 2021, when banks' commitments to submit data for purposes of LIBOR are due to end. The Working Group suggests certain steps market participants could take to mitigate some of the risks arising where LIBOR continues to be referenced in new Sterling bonds issued in the interim period before market conventions and infrastructure for referencing alternatives to LIBOR are fully developed.

The paper is available at: https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/risk-free-reference-rates-new-issuance-of-sterling-bonds-referencing-libor.pdf.

Shadow Banking

European Commission Requires Drafting Amendments to Proposed Technical Standards for Reporting of Securities Financing Transactions

On July 27, 2018, the European Commission published a Communication announcing its intention to adopt, with amendments, the RTS and Implementing Technical Standards prepared by ESMA under the Securities Financing Transactions Regulation. ESMA submitted final draft RTS and ITS to the Commission in March 2017.

The Commission has amended the draft RTS on the details of Securities Financing Transactions to be reported to Trade Repositories and the draft ITS on the format and frequency of reports on the details of SFTs to TRs. The draft RTS and ITS had contained wording to the effect that ESMA would have the power to endorse global unique trade identifiers for transactions or the global legal identifier system as it applies to the branch of an entity. This wording would have had the effect of delegating regulatory powers on potential future reporting requirements directly to ESMA, which is not possible under the legal framework for the European Supervisory Authorities. The Commission has made amendments to clarify that the Commission, rather than ESMA, has the responsibility to introduce changes to the reporting requirements, on the basis of a proposal by ESMA.

ESMA will have a six-week period in which to re-submit the draft RTS and ITS in the form of a formal opinion, after which the Commission may adopt the amended technical standards.

Although the issue over the wording referring to endorsement by ESMA only came to light during the Commission's consideration of ESMA's draft RTS and ITS for the SFTR, to ensure legal certainty and consistency, the Commission also asks ESMA to submit a proposal amending Commission Implementing Regulation (EU) 2017/105, which sets out ITS for the format and frequency of reports to TRs under the European Market Infrastructure Regulation, to remove similar references within that Implementing Regulation to "endorsement by ESMA."

The Commission proposes to adopt—without amendments—the draft RTS and ITS submitted by ESMA on: (i) the registration and extension of registration of TRs under SFTR (and a linked amendment to related RTS under EMIR); (ii) operational standards for data collection, data aggregation and comparison, public data and details of SFTs; (iii) procedures and forms for submitting information on sanctions and measures; and (iv) access levels and terms of use under the SFTR (and a linked amendment to related RTS under EMIR). However, cross-references in the legal texts mean that these further RTS and ITS can only be adopted jointly with the draft RTS and ITS ESMA has been asked to amend. Accordingly, all of the RTS and ITS will be adopted together in due course.

The Commission Communication is available at: http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4730-F1-EN-MAIN-PART-1.PDF and the letter to ESMA is available at: http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4730-F1-EN-ANNEX-1-PART-1.PDF.

Upcoming Events

September 4, 2018: EBA public hearing on its consultation on draft RTS for calculation of KIRB for securitized exposures

September 4, 2018: EBA public hearing on its consultation on draft Guidelines on outsourcing arrangements

September 4-5, 2018: OECD blockchain conference: Unleashing the potential and facing the challenges of blockchain (registration closes August 30, 2018)

September 11, 2018: FCA annual public meeting at which the FCA's 2017/2018 Annual Report will be discussed

October 15, 2018: SRB Conference 2018–10 years after the crisis: are banks now resolvable?

November 28, 2018: EBA 7th Annual Research Workshop–Reaping the benefits of an integrated EU banking market

Upcoming Consultation Deadlines

August 13, 2018: EBA consultation on draft Guidelines on the conditions to be met to benefit from an exemption from contingency measures under the RTS on strong customer authentication and common and secure communication

August 17, 2018: ECB consultation on a draft Regulation proposing the materiality threshold for credit obligations past due under the CRR

August 17, 2018: FATF consultation on draft Risk-Based Approach Guidance for the securities sector

August 20, 2018: FSB call for feedback on the technical implementation of the TLAC Standard

August 20, 2018: FSB consultation on a draft cyber lexicon

August 22, 2018: PRA consultation on Securitization: the new EU framework and significant risk transfer

August 24, 2018: U.K. CMA consultation on proposed remedies to adverse competition in the investment consultancy and fiduciary management markets

August 30, 2018: ESMA consultation on extending the exemption from the clearing obligation for intragroup transactions with third-country group entities

September 3, 2018: PSR discussion paper on use of data in the payments industry

September 4, 2018: CFTC's proposed amendments to SRO surveillance programs for FCMs

September 7, 2018: FMSB consultation on a draft statement of good practice on algorithmic trading

September 7, 2018: ESMA consultation on amendments to the MiFID II tick size regime

September 17, 2018: Comment deadline for Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (proposed changes to the Volcker Rule)

September 17, 2018: U.K. BEIS consultation on a draft Bill introducing a register of the beneficial owners for overseas legal entities that own U.K. property

September 19, 2018: EBA consultation on draft RTS for calculation of KIRB for securitized exposures

September 21, 2018: FCA interim report (MS 17/1.2) on its investment platform market study

September 24, 2018: EBA consultation on draft Guidelines on outsourcing arrangements

September 25, 2018: PRA consultation on reflecting the Systemic Risk Buffer framework within the Leverage Ratio framework for U.K. systemic ring-fenced bodies

September 26, 2018: ESMA consultation on revised Guidelines for periodic reporting by credit rating agencies

September 28, 2018: FCA call for input on the PRIIPs Regulation

September 30, 2018: BoE consultation on term SONIA reference rates

October 5, 2018: ESMA consultation on minimum information content of exempted documents under the Prospectus Regulation

October 5, 2018: ESMA consultation on draft guidelines on risk factors under the Prospectus Regulation

October 5, 2018: BoE/PRA/FCA Discussion Paper on operational resilience of firms and FMIs

October 5, 2018: FCA consultation on a new workers directory

October 5, 2018: Law Commission consultation on reform of the anti-money laundering regime for England and Wales

October 12, 2018: ISDA consultation on fall backs based on overnight risk-free rates for certain derivatives

October 27, 2018: FCA consultation on proposed changes to the rules governing P2P platforms

November 2, 2018: FCA discussion paper on the potential introduction of a new duty of care for financial services firms

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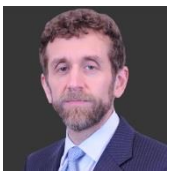

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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